lowed the requirements of the pertinent depreciation regulations adopted by the Commissioner of Internal Revenue under section 167 of the Internal Revenue Code of 1954, T.D. 6182, 26 C.F.R. sec. 1.167 (a) *et seq.* (R. 29a-30a). At the time of the acquisition of the vehicles, petitioner estimated the period of their useful life in its leasing business (R. 17a, 21a, 30a); it then estimated the salvage value of the vehicles as of the end of that period of useful life; and, basing its calculations on these estimates, petitioner established a depreciation rate which would return, as a reasonable depreciation deduction during the period of the estimated useful life, the cost less estimated salvage value (R. 30a; see R. 21a, 30a). When the leases were terminated and the vehicles were returned from lease, petitioner disposed of them either by trading them for new vehicles or by selling them at wholesale (R. 16a, 21a-25a). Of the vehicles disposed of by sale, many were sold at losses, that is to say, the selling price received for the vehicles was less than their book value (depreciated or adjusted basis) at the time of sale. In those instances where the selling price received for the vehicles exceeded their book value at the time of sale, the resulting gains were reported by petitioner at the capital gains rate in accordance with section 1231 of the Internal Revenue Code of 1954. (R. 28a, 21a-25a).[3]

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[3] During the year ending September 30, 1957, petitioner disposed of 133 vehicles by sale; 50 sales resulted in losses, and 83 resulted in gains (R. 21a-22a). During the year ending September 30, 1958, petitioner disposed of 317 vehicles by sale; 112 resulted in losses, and 205 resulted in gains (R. 22a-23a). During the year ending September 30, 1959, petitioner disposed of 353 vehicles by sale; 114 sales resulted in losses, and 239 resulted in gains (R. 23a). During the year ending September 30, 1960, petitioner disposed of 387 vehicles by sale; 129 sales resulted in losses, and 258 resulted in gains (R. 24a).

The Commissioner did not and does not challenge the depreciation plan adopted by petitioner. As stated by District Judge Blumenfeld (R. 47a): "In open court * * * the government admitted that the plaintiff's estimate of useful life was reasonable, that its estimate of salvage value was reasonable, and that its method of computing depreciation was proper. It does not make any claim that the method of depreciation used by taxpayer was improper or that there was any unreasonable, mistaken or improper use of any element in the method adopted by the taxpayer." Notwithstanding the fact, however, that petitioner, in adopting its depreciation allowance, had concededly complied with all the requirements of the applicable regulations, the Commissioner nonetheless disallowed depreciation deductions claimed during the year of sale with respect to all vehicles that were sold at a gain. (R. 10a, 28, R. 58a, Appendix A, *infra,* p. 2a). The basis for the Commissioner's disallowance was twofold. ***First,*** if the book value of a vehicle at the beginning of the year of sale was greater than its selling price, then any depreciation during the year of sale which would reduce the book value below the actual selling price was disallowed. This, of course, eliminated all capital gain arising out of the sale of such vehicle.[4] ***Second,*** if the book value of a vehicle at the beginning of the year of sale was less than the selling price, then all depreciation for such vehicle for the year of sale was disallowed, thereby limiting any gain to the difference

[4] For example, assume a book value (adjusted basis) for a vehicle at the beginning of the year of sale of $2,000.00, and claimed depreciation during that year of $400.00. If the vehicle were sold for $1700.00, and a $100.00 gain were reported, the Commissioner disallowed depreciation in the amount of $100.00, eliminating all gain.

between selling price and book value as of the beginning of the year of sale.[5] (R. 6a-7a, 10a, 58a, Appendix A, *infra,* p. 2a; see R. 40).

The application of this rigid formula to all sales where gains were reported resulted in the disallowance of depreciation deductions in some instances in such small amounts as $0.03, $2.82, $4.70 and $2.33 with respect to vehicles whose original costs were $2194.85 $2310.49, $2037.09 and $2803.17 respectively. (R. 27a, 38a).

After payment of the deficiencies based on the foregoing adjustments of depreciation deductions, and after rejections of the required claims for administrative refund, petitioner brought this action for refund in the United States District Court for the District of Connecticut claiming that the action of the Commissioner arbitrarily disregarded the provisions of section 167 of the Internal Revenue Code and the regulations thereunder (R. 15-20, R. 58a,. Appendix A, *infra,* pp. 2a-3a.) After hearing on cross-motions for summary judgment (R. 8a, 13a-27a), District Judge Blumenfeld granted petitioner's motion and entered judgment in its behalf (R. 54a-55a).

The District Court set forth its views in a lengthy opinion in which it analyzed in detail the pertinent regulations issued under section 167 of the Internal Revenue Code of 1954. (R. 28a-53a). It concluded that petitioner had fully complied with all require-

[5] For example, assume a book value (adjusted basis) for a vehicle at the beginning of the year of sale of $2,000.00 and claimed depreciation during that year of $50.00. If the vehicle were sold for $2,025.00, the Commissioner disallowed the entire claimed depreciation of $50.00, but a capital gain in the amount of $25.00 remained.

ments of the pertinent regulations and that the Commissioner's action in disallowing depreciation in the year of sale was not authorized or supported by any provision of those regulations. The decisions of this Court in *Massey Motors, Inc.* v. *United States* and *Commissioner* v. *Evans,* 364 U.S. 92, were carefully analyzed and were found to support petitioner's claims and bar the action of the Commissioner.

On appeal to the court below, the District Court's ruling was reversed (Appendix A, *infra,* pp. 1a-3a), Circuit Judge Waterman dissenting (Appendix A, *infra,* pp. 3a-4a) The reversal was "on the authority of, and for the reasons given in *Fribourg Navigation Co.* v. *Commissioner*" (Appendix A, *infra,* p. 2a) which was decided on the same day by an entirely different panel of the same court; with Circuit Judge Moore dissenting.[6]

The Commissioner's action in disallowing depreciation in the year of sale whenever a gain was reported[7] was sustained, in essence, on the theory that, no matter how reasonable the taxpayer's original estimate may have been, after an asset has been sold and its selling price established with certainty, it is not unreasonable to deny a taxpayer any depreciation deduction which would have the effect of either creating or increasing a capital gain, for the reason that the Internal Revenue Code and the regulations thereunder were not designed to encourage the "transmutation of ordinary income

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[6] We have been advised that a petition for a writ of certiorari is also being filed in the *Fribourg Navigation Co.* case.

[7] Hereafter, when reference is made to the disallowance of depreciation in the year of sale, we refer to either the partial or total disallowance, depending on the book value at beginning of the year of sale. See *supra,* p. 5, n. 4 and p. 6, n. 5.

into capital gains". (Appendix A, *infra,* p. 3a). The majority opinions in this case and in the *Fribourg Navigation Co.* case made no analysis of this Court's decisions in *Massey Motors* and *Evans,* nor was any reference even made to them.[8]

REASONS FOR GRANTING THE WRIT

We respectfully submit that this petition for a writ of certiorari should be granted for the following reasons: The simple formula approved by the court below requiring a routine and automatic disallowance of depreciation during the year of sale of an asset, whenever an asset is sold at a gain,—although it has a "beguiling appeal to it" (*Macabe Co., Inc., et al.* v. *Commissioner,* 42 T.C. No. 87, p. 8, September 29, 1964),[9]—is in violation of the pertinent provisions of the Internal Revenue Code of 1954 and the regulations promulgated thereunder by the Commissioner of Internal Revenue. The decision below is in conflict with the fundamental and basic principles concerning the nature and purposes of the depreciation allowance and of depreciation accounting enunciated by this Court in the *Massey Motors* and *Evans* cases, 364 U.S. 92, and the question presented remains one of substantial and continuing importance.

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[8] The District Court had found additional support for its position in the Congressional enactment in 1962 of legislation adding section 1245 to the Internal Revenue Code of 1954 (R. 48a-52a), a view not accepted by the court below (Appendix A, *infra,* pp. 10a-11a), but with which we concur. See also *Macabe Company, Inc.* v. *Commissioner,* 42 T.C. No. 87, filed September 29, 1964, pp. 24-25.

[9] For the convenience of the Court, we are submitting herewith nine copies of the *Macabe Co.* opinion.

1. Section 167 of the Internal Revenue Code of 1954 (Appendix B, *infra,* p. 22a) permits a taxpayer to deduct from income a "reasonable allowance" as a "depreciation deduction" for the property used in the taxpayer's business. See *Detroit Edison Co.* v. *Commissioner,* 319 U.S. 98, 101; *United States* v. *Ludey,* 274 U.S. 295, 305.[10] The Commissioner has issued lengthy and detailed regulations setting forth how the "reasonable allowance" shall be determined by a taxpayer (T.D. 6182, 26 C.F.R. 1.167(a) *et seq.,* (Appendix B, *infra,* pp. 23a-28a),[11] and an examination of those regulations will disclose the clear conflict between those regulations and the decision of the court below.

The regulations define the depreciation allowance as the "amount which should be set aside for the taxable year in accordance with a reasonably consistent plan * * *, so that the aggregate of the amounts set aside, plus the salvage value, will, at the end of the estimated useful life of the depreciable property, equal the cost or other basis of the property." Section 1.167(a)-1(a). "Salvage value" is defined, not as the amount actually received upon the sale of an asset, but as "the amount (determined at the time of acquisition) which is estimated will be realizable upon sale or other disposition of an asset when it is no longer useful in the taxpayer's trade or business", and it is specifically provided that "salvage value shall not be changed at any time after the determination made at the time of acquisition

[10] Section 1231 of the Code provides that, upon the sale of such depreciable property, the excess of the selling price over the depreciated basis (book value) of the asset at the time of sale shall be treated, for tax purposes, on a capital gain basis, if the property was held for more than six months.

[11] Hereafter, we shall refer to the regulations only by their section numbers which are the same as in 26 C.F.R.

merely because of changes in price levels." Section 1.167(a)-1(c).[12] The regulations provide further that the "estimated useful life of an asset is not necessarily the useful life inherent in the asset but is the period over which the asset may reasonably be expected to be useful to the taxpayer in his trade or business." Section 1.167(a)-1(b).[13]

Accordingly, a taxpayer in adopting a depreciation plan for an asset, must first *estimate* the period of useful life of the asset in the business, must then *estimate* the salvage value as of the end of that period, and must then set up as a depreciation allowance the cost less the *estimated* salvage value spread over the *estimated* useful life of the asset. The regulations are not silent concerning when the depreciation allowance begins and when it ends, and it is specifically pro-

[12] It should be noted that the depreciation allowance is defined as the cost less the estimated salvage value, not as the cost less the actual selling or disposal price. This definition is sound because the allowance is a deduction to be taken currently during the use of an asset at a time when its disposal or selling price is unknown. The selling price, accordingly, is no part of the depreciation formula, other than as a measure of its reasonableness, and the definition in the regulations properly implements the statutory definition of depreciation in section 167 of the Internal Revenue Code which provides for a "reasonable allowance" rather than the specific amount of cost less actual selling or disposal price. There is no contention in this case that petitioner has claimed or is claiming more than cost less estimated salvage; what the Commissioner apparently contends is that, after disposal of an asset, his own definition of depreciation is no longer applicable.

[13] The District Court has referred to significant changes in the language of the regulations, adopted during the course of their consideration, which, in its view, emphasize the nature of the depreciation allowance as cost less estimated salvage value, rather than cost less actual disposal or selling price. See R. 31a-32a. See also *Macabe Company, Inc. et al.* v. *Commissioner*, 42 T.C. No. 87, p. 13.

vided that "The period for depreciation of an asset shall begin when an asset is placed in service and shall end when the asset is retired from service." Section 1.167(a)-10(b).[14] Nor are the regulations silent concerning the limitation below which depreciation may not go. They specifically provide that "an asset shall not be depreciated below a *reasonable salvage value* under any method of computing depreciation". Section 1-167(a)-1(a) (Italics added); see also Section 1-167(a)-1(c) ("in no event shall an asset (or an account) be depreciated below a reasonable salvage value.")[15] The limitation is *reasonable salvage value,* not actual selling price. See R. 29a, 31a; see also the opinion of Judge Waterman, dissenting below. Appendix A, *infra,* p. 4a; *Massey Motors Inc.* v. *United States,* 364 U.S. at 107; *Hertz Corp.* v. *United States,* 364 U.S. 122, 127 ("There is nothing inherent in the declining balance system which requires us to assume that depreciation should be allowed beyond what *reasonably appears to be the price that will be received* when the asset is retired") (Italics added)

It is plain, therefore, that the depreciation allowance is based on a system of *estimates* made at the time of acquisition of an asset, rather than on precise figures which become known only after its sale, and it is a necessary consequence of such a system that

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[14] The ruling of the court below, is, of course, in the teeth of the above provision. The court below would have depreciation end, not "when the asset is retired from service" as the regulations provide, but whenever, either at the beginning of or during the year of sale, the actual selling price had been reached.

[15] The ruling of the court below is, of course, also in the teeth of the above provision. The court below would have depreciation end not when "reasonable salvage value" has been reached, but when the actual selling price, known later, has been reached.

either the realization of some gains or the sustaining of some losses are normal events upon the disposition of depreciable assets and not merely rare and unforeseen possibilities.[16] Only in the rare case could the estimate of salvage value equal the actual selling price to the cent. The regulations, consistent with section 1231 of the Code, recognize this and specifically provide in section 1.167(a)-8(a)(1) for the capital gain treatment of any gain realized upon disposition of a depreciable asset after the "reasonable allowance" for depreciation had been taken. As the District Court aptly stated in this case (R. 39a), "The guide for the taxpayer, and the standard for the commissioner, is that of reasonableness. 'Reasonable allowance' is the theme for depreciation in the statute, and the regulations faithfully repeat it. See *Massey Motors Inc.* v. *United States, supra.*"[17]

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[16] "Of course, there is a risk of error in such projections, but prediction is the very essence of depreciation accounting." *Massey Motors, Inc.* v. *United States*, 364 U.S. at 105. See also *Wyoming Builders, Inc.* v. *United States*, 227 F. Supp. 534, 537. *S & A Co.* v. *United States*, 218 F. Supp. 677 (D. Minn.); see also *Detroit Edison Co.* v. *Commissioner*, 319 U.S. 98, 101 (the purpose of the depreciation allowance is to "*approximate and reflect* the financial consequences to the taxpayer of the subtle effects of time and use on the value of his capital assets") (Italics added.)

[17] The court below stated (Appendix A, *infra*, p. 3a): "Where it may be determined to an absolute certainty that such a profit will result from the allowance of further depreciation, as is the case here, there is no basis in reason or policy to permit the taxpayer to take advantage of what has proved to be an *inaccurate* estimate of salvage value." (Italics supplied). But herein lies the basic error of the court below. The question is not whether the estimate was accurate to the cent; the requirement is that it be reasonable. Further there is no "profit" that results to the taxpayer. It is the cost only that is being returned, and the question is what two elements add up to that cost—the depreciation plus estimated salvage value or depreciation plus actual selling price—, and, as to this, the regulations, as we have shown, are clear. See *supra*, pp. 9-12.

It is clear, we submit, that the foregoing regulations foreclose the Commissioner's rule, approved by the court below, of automatically disallowing a deduction for depreciation in the year in which an asset is sold for more than its adjusted basis.

The majority of the court in *Fribourg Navigation Co.* v. *Commissioner* (Appendix A, *infra*, pp. 9a-10a) purported to find support for the Commissioner's view in one sentence of one paragraph of the regulations which provides that "The reasonableness of any claim for depreciation shall be determined upon the basis of conditions known to exist at the end of the period for which the return is made." Section 1.167(b)-O-(a). But reliance upon that one sentence is plainly misplaced. As the District Court properly noted with respect to this provision, "But, even here the test for allowable depreciation is still its reasonableness, * * * it does not automatically follow that a price received upon the sale of a depreciable automobile, somewhat greater than estimated, when it was acquired fourteen months before, established that the estimate and the depreciation based upon it was unreasonable" (R. 38a).[18] But more than that, that sentence is contained in a general section entitled, "Methods of computing depreciation—(a) in general", and relates to the reasonableness of a taxpayer's overall continuing depreciation plan. It follows immediately after a sentence dealing generally with recovery, by way of depreciation, of cost less estimated salvage over the "remaining useful life of the property", and, contained in the same paragraph,

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[18] See also *Macabe Company Inc., et al.* v. *Commissioner*, 42 T.C. No. 87, pp. 16-18, decided September 29, 1964 wherein the Tax Court stated that the Commissioner reads too much into the provision and that it does not provide the authority the Commissioner asserts, particularly in light of the other specific provisions of the regulations already referred to.

is the provision that claimed depreciation deductions "will be changed only where there is a clear and convincing basis for a change". Not one word is stated about actual selling price automatically requiring adjustments. This hardly seems to be a provision designed to require the disallowance of depreciation in the year of sale in every case where a gain is reported, however, small.[19]

2. The decision of the court below is in conflict with the principles enunciated by this Court in *Massey Motors, Inc.* v. *United States* and *Commissioner* v. *Robley H. Evans*, 364 U.S. 92. The specific question involved in those cases was whether the period of estimated useful life of an asset for depreciation purposes

[19] The rule adopted by the court below, presumably on the authority of *Cohn* v. *United States*, 259 F. 2d 371 (C.A. 6), limits the disallowance of depreciation to the year of sale only—a rule which the court below itself characterized as "perhaps logically inconsistent." Appendix A, *infra*, p. 7a. See the comments of Judge Moore dissenting in *Fribourg Navigation Co.*, Appendix A, *infra*, pp. 14a-15a). The effect of this rule could obviously be avoided merely by holding assets until a few days after the close of a tax year and then selling them. For example, in this case, every penny of disallowed depreciation could, under the rule adopted by the court below, have legitimately been retained by petitioner if the vehicles had been held until a few days into new tax years. Consequences such as this debase the depreciation concept, and a rule which so provides has a similar effect. Furthermore, the theory adopted by the court below invites abuse of the depreciation allowance. It eliminates arbitrarily all capital gain that might legitimately arise by reason of reasonable depreciation deductions during the year of sale, but at the same time, it permits the retention of a capital gain developed by excessive depreciation deductions in the years *prior* to the year of sale. This, of course, provides no incentive for reasonable estimates; on the contrary, it invites unreasonable estimates so as to increase early depreciation deductions, thereby reducing the basis of an asset below selling price *prior* to the year of sale and creating a gain which concededly may be retained. A more perverse reading of the statute and regulations is difficult to envisage.

was the period of estimated useful life in the business of the particular taxpayer, or the total period of physical or economic life of the asset. In concluding that useful life was the estimated period of use in the particular taxpayer's business, this Court pointed out that the primary purpose of depreciation accounting was "to further the integrity of periodic income statements by making a meaningful allocation of the cost entailed in the use * * * of the asset to the periods to which it contributes" *Id.* at 104. In order to accomplish this purpose, the Court stated, a taxpayer must "estimate the period the asset will be held in the business and the price that will be received for it on retirement. Of course, there is risk of error in such projections, but prediction is the very essence of depreciation accounting". *Id.* at 105.

This Court was fully aware that, upon sale of a depreciable asset, any gains "are capital gains and incur no more than a 25% tax rate" (*Id.* at 97), and it appreciated full well that its definition of useful life would not result in always eliminating a capital gain by equating estimated salvage value with selling price, as the Commissioner has done here. This Court's definition of useful life merely represented an approach which was "far more *likely to reflect* correctly the actual cost over the years in which the asset is employed in the business". *Id.* at 106. (Italics Supplied).[20] Indeed, in the *Evans* case, the Commissioner,

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[20] The Court concluded "that the Congress intended that the taxpayer should, under the allowance for depreciation, recover only the cost of the asset less the *estimated* salvage, resale or second-hand value. This requires that the useful life of the asset be *related* to the period for which it may *reasonably* be expected to be employed in the taxpayer's business. Likewise salvage value must include *estimated* resale or second-hand value." *Id.* at 107. (Italics Supplied). See *supra*, p. 10, n. 12, and p. 12, n. 17.

in properly insisting that the taxpayer should have depreciated its vehicles on the basis of the period of estimated use in its business, with salvage value estimated as of that time, did not disallow depreciation in the year of sale, as such, nor did he attempt to equate estimated salvage value with actual sales price in order to eliminate a capital gain. The Commissioner, himself, in revising the taxpayer's claimed depreciation deductions, made the very estimates that the taxpayer should have made in the first place. Knowing that the vehicles had already been sold for $1380.00, he *estimated* reasonable salvage value at $1325.00 and allowed depreciation down to that figure, thereby permitting a capital gain in the amount of $55.00 per car, all of which resulted from depreciation deductions during the year of sale down to a reasonably estimated salvage value, but below an already known selling price. These facts are specifically alluded to in this Court's opinion. 364 U.S. at 94-95.[21] What the Commissioner did in *Evans,* and what was approved by this Court in that case as the proper method of computing the "reasonable allowance" for depreciation, is precisely what petitioner has done here and what the court below has disapproved.

In the Government's brief to this Court in the *Evans* case, the Commissioner argued, and properly we think, that the depreciation allowance was not intended to be a device to convert ordinary income into capital gains. In arguing that such an improper conversion of ordi-

[21] As District Judge Blumenfeld pointed out (R. 37a): "Indeed, it is clear that the commissioner did not even argue in *Massey* for the proposal he asserts here. In calculating the taxpayer's deficiencies, he used an estimated salvage value of $1325.00 per car, rather than $1380.00, which was the actual selling price. He was not trying to eliminate all interplay between § 167 and § 1231."

nary income into capital gains would not result from the adoption of his definitions of "useful life" and "salvage value", even though capital gains would often be involved (see Brief for the Commissioner in this Court in the *Evans* case, No. 143, Oct. Term, 1959, pp. 10-11, 16-17), the Commissioner pointed out (Id at p. 29):

> On the other hand, if, as the Commissioner contends, the depreciation deduction must be based upon a rate determined by the period during which the asset can reasonably be expected to be used in the taxpayer's business and a reasonable estimate of salvage value at the end of that period, there will be no conversion of ordinary income into capital gains. *Ordinary and predictable salvage value, determined as of the time that sale of the asset is contemplated, will impose a realistic ceiling upon depreciation claims.*" (Italics added)

Throughout the Commissioner's briefs in *Massey* and *Evans* there was not one single reference to any principle of disallowing depreciation in the year of sale whenever a gain was reported. The decision in *Cohn* v. *United States*, 259 F. 2d 371 (C.A. 6), which apparently is relied on for the principle (R. 39a *et seq*), had been decided long before the Government's briefs were filed in *Massey* and *Evans*, and yet no reference was made to the *Cohn* case as authority for any such proposition.[22]

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[22] In the companion case, *Hertz Corp.* v. *United States*, 364 U.S. 122, the Government's Brief (No. 283, Oct. Term, 1959, pp. 32, n. 6 and 40) quotes from *Cohn* (259 F. 2d at 377) only for the general proposition that salvage value must be estimated and taken into consideration, and on page 50, n. 27 it describes the holding as follows: "Taxpayers in that case had not deducted any salvage value in the first instance (though they were operating under the straight line method) *and the court appropriately held that no*

It is clear that what was approved by this Court in the *Massey* and *Evans* cases as the proper method of computing the "reasonable allowance" for depreciation is precisely what the court below has disapproved,—and without even a reference to this Court's opinion.[23]

Our view of this Court's decision in *Massey Motors* and *Evans* is sustained by the recent decision of the Tax Court in *Macabe Company, Inc.* v. *Commissioner,* 42 T.C. No. 87, filed September 29, 1964. There the Tax Court, in an opinion reviewed by the court, set aside the Commissioner's disallowance of depreciation deductions during the year of sale with respect to an office building whose book value at the beginning of the year of sale was less than the price for which it was sold. The Commissioner's disallowance was based on the contention, made here also, that "if a depreciation deduction were allowed in the year of sale when the sales price equals or exceeds a taxpayer's undepreciated basis as of the beginning of said year, the taxpayer would, in effect, be recovering, tax free, more than the cost to him of the asset" (pp. 7-8). The Tax Court noted that the Commissioner's contention "has, because of its simplicity, a beguiling appeal to it", but

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further depreciation deductions were allowable after the assets had been depreciated down to reasonable salvage value." (Italics added). This, of course, is a far cry from any proposition requiring an automatic disallowance of depreciation in the year of sale geared to selling price as contrasted with "reasonable salvage value".

[23] Circuit Judge Moore, in his dissenting opinion in the *Fribourg Navigation Co.* case stated (Appendix A, *infra,* p. 17a): *"Motorlease* as decided by this court (the court below) in substance and actuality goes contrary to the decisions of the Supreme Court in *Massey* and *Evans.* * * * *Motorlease* was analogous to, and should have been controlled by, *Massey, Evans* and *Hertz.* Yet there is no consideration of, or even mention of, those important cases or the legal principles declared therein."

concluded that "a closer scrutiny of respondent's (Commissioner's) argument convinces us that it is incorrect * * *" (p. 8). After reviewing the provisions of sections 167 and 1231 of the Internal Revenue Code and the Commissioner's regulations under section 167, and after analyzing the opinion of this Court in *Massey Motors* and *Evans* in detail, the Court held that the Commissioner "has failed to comply with the underlying intent of section 167 and the specific provisions of his own regulations thereunder" (p. 8). In essence, the Tax Court held that if the required estimates of useful life and salvage value were reasonably made, then there can be no automatic disallowance of depreciation in the year of sale simply because the actual selling or disposal price may have exceeded the estimated salvage value. The Court specifically stated that it disagreed with the rationale of the court below in both *Motorlease* and *Fribourg Navigation Co.*, even though its own decision in *Fribourg Navigation Co.*, had been affirmed by the court below.[24] It seems quite

[24] The Tax Court stated, however, that it agreed with the *results* in those cases. With respect to *Motorlease*, Judge Fay wrote (p. 11a, n. 10): "There is no indication in that case that the excess of sales price received over the estimate of salvage value resulted from an increase in market values. In fact, the opinion of the Circuit Court therein suggests that this excess resulted from an inaccurate estimate." Apparently, Judge Fay looked no further than the majority opinion of the court below, for the record in *Motorlease* and the District Court's opinion show clearly that the estimates in *Motorlease* were reasonable and were conceded to be so (R. 30a, 47a). Since, however, under the view of the majority of the court below, the reasonableness of estimates was not deemed to be a controlling factor, it is apparent that when Chief Judge Lumbard referred to "an inaccurate estimate" of salvage value (Appendix A, *infra*, p. 3a), he referred to any instance where selling price exceeded the estimate of salvage value. But Judge Fay's opinion rejects that view, and his concurrence in the result in *Motorlease* is based on an apparent misunderstanding of the facts. The Tax Court's opinion in *Macabe* is plainly in conflict with the decision below.

clear that the Tax Court has now abandoned and rejected the view earlier expressed in its own *Fribourg Navigation Co.* decision even though it was affirmed by the court below in the decision which was the basis for the decision in this case.[25] The Tax Court's strong reliance on the opinion of this Court in *Massey Motors* and *Evans* in reaching its present conclusions in *Macabe* emphasizes the conflict between the decisions below and this Court's opinion in *Massey Motors* and *Evans*. See also *S & A Company* v. *United States*, 218 F. Supp. 677 (D. Minn. 1963); *Kimball Gas Products Co.* v. *United States*, 63-2 U.S.T.C. par. 9507 (W.D. Tex. 1962); *Wyoming Builders, Inc.* v. *United States*, 227 F. Supp. 534 (D. Wyo. 1964); cf. *Killebrew* v. *United States*, 14 AFTR 2d 5565 (E.D. Tenn. 1964).

3. Finally, the question presented in this case is of substantial importance in the administration of the tax laws, not only to taxpayers, but also to the Internal Revenue Service. The question whether depreciation can or must be disallowed in the year when an asset is sold at a gain arises not out of unusual or rare circumstances, but, indeed, can be involved in practically every sale of real or personal depreciable property used in business. The question has not been limited to cases involving the sale of leased vehicles, as in this case, or

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[25] Since its decision in *Macabe*, the Tax Court, on the authority of *Macabe*, has set aside the Commissioner's disallowance of depreciation deductions during the year of sale in the following cases: *C. L. Nichols et al* v. *Commissioner*, 43 T.C. No. 13, filed November 6, 1964. *Harry Trotz et al* v. *Commissioner*, 43 T.C. No. 14, filed November 6, 1964; *Moses Lake Homes, Inc.* v. *Commissioner*, T.C. Memo. 1964-289, filed November 5, 1964; *Palmaneda Adams* v. *Commissioner*, T.C. Memo. 1964-286, filed October 30, 1964. And see *Smith Leasing Co. Inc.* v. *Commissioner*, 43 T.C. No. 5, October 20, 1964, in which the *Macabe* decision was distinguished on the facts.

vessels, as in the *Fribourg Navigation Co.* case. It has been and is currently involved in cases dealing with the sale of all variety of depreciable property, both real and personal. See *e.g., S & A Company* v. *United States, supra; Kimball Gas Products Co.* v. *United States, supra; Wyoming Builders, Inc.,* v. *United States, supra; Macabe Company, Inc.* v. *Commissioner, supra; Killebrew* v. *United States, supra,* and cases cited in footnote 25, *supra,* p. 20.

In 1962, long after the Commissioner acted in this case and many months after the complaint was filed herein by petitioner, the Commissioner issued Rev. Rul. 62-92 (1962-1 Cum. Bull, 29) adopting the position asserted herein as Service policy in all cases involving the sale at a gain of all depreciable assets used in the trade or business. We are unable to estimate the number of cases dealing with this question that are now pending in the federal district courts and in the Tax Court or the number of cases that are either pending or being developed within the Internal Revenue Service. Petitioner has been informed by the American Automotive Leasing Association, of which it is a member, that, of the seventy company members of that Association, at least thirty companies already have cases pending within the Service for open tax years which involve the issue in this case. The number of cases will undoubtedly increase substantially when further audits for open years are completed, particularly in view of the adoption of Rev. Rul. 62-92.[26] It should

[26] The scope of Rev. Rul. 62-92 will undoubtedly be narrowed for the future because of the additions to the Internal Revenue Code of section 1245 in 1962 and section 1250 in 1964. Section 1245 removes the capital gains treatment with respect to personal property and certain real property sold during a taxable year after December 31, 1962 to the extent of depreciation taken after

be pointed out that the foregoing figures are only for those long-term vehicle leasing companies who are Association members. They do not include non-member vehicle leasing companies; nor do they include daily rental companies or truck leasing companies or equipment leasing companies. Moreover, since the question herein may be pending in any case involving the sale at a gain of any real or personal depreciable property used in business, the number of pending cases is in all probability extremely large, and the amount of taxes involved must necessarily be—conservatively speaking—extremely substantial, involving untold millions of dollars.

Cases presenting this issue are now pending on appeal in other Circuits. The *S & A* case, *supra,* is pending on appeal to the Eighth Circuit; the *Kimball Gas Co.* case, *supra,* is pending on appeal to the Fifth Circuit; and the *Wyoming Builders* case, *supra,* is pending on appeal to the Tenth Circuit. All of these decisions were decided against the Commissioner and in favor of the taxpayers in the District Courts. But see *Killebrew* v. *United States, supra.* The recent Tax

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December 31, 1961. Section 1250 removes the capital gains treatment with respect to real estate (not subject to section 1245) sold after December 31, 1963 to the extent of depreciation taken after December 31, 1963 if the property was held for one year or less, or to extent of the excess of such depreciation over straight line depreciation if the property was held for more than a year, but not more than 20 months. If the real property was held for more than 20 months, the amount treated as ordinary income is reduced by one percent for each full month over 20 that the property was held.

But even with these additions to the Internal Revenue Code, the question is still very much involved for the future with respect to the sale of real estate held for more than one year on which straight line depreciation had been taken. It is also involved to a more limited extent even where accelerated depreciation had been taken and the real proprty was held more than 20 months.

Court decision in the *Macabe* case, *supra,* will, if appealed by the Government, go to the Ninth Circuit, and, in any event, will undoubtedly be followed by other Tax Court decisions to be appealed to other Circuits. See *e.g.,* the cases cited in footnote 25, *supra,* p. 20.

We respectfully submit that it is important to the administration of the tax laws that the specific issue herein be definitively settled by this Court at this time. It is apparent from the cases to which we have referred that, in spite of what we believe was a clear and lucid enunciation of guiding principles by this Court in *Massey Motors and Evans,* there is, nevertheless, at the present time, a confusion of decision and a conflict of understanding that should be resolved. Both cases below had vigorous dissenting opinions; the Tax Court has apparently changed its mind; and the District Courts reach different results. This situation breeds litigation unnecessarily, casting an undue and unreasonable burden not only on the courts, but also on the litigants, both Government and private.

CONCLUSION

For the foregoing reasons, therefore, it is respectfully submitted that the petition for a writ of certiorari in this case should be granted.

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APPENDIX A

UNITED STATES OF AMERICA, *Appellant,*

v.

THE MOTORLEASE CORPORATION, *Appellee.*

No. 232, Docket 28470.

United States Court of Appeals
Second Circuit.

Argued Jan. 28, 1964.

Decided July 15, 1964.

* * * * * * * * * *

Before LUMBARD, Chief Judge, and WATERMAN and MARSHALL, Circuit Judges.

LUMBARD, Chief Judge:

[1] The question presented is whether a taxpayer may take a depreciation deduction for the year of sale of a depreciable asset in excess of the amount by which the adjusted basis of the asset at the beginning of the year of sale exceeds the amount realized upon the sale. In other words, may a taxpayer, for example, claim depreciation in excess of $250 when the adjusted basis of the asset at the beginning of the taxable year is $1000 and the asset is sold during the taxable year for $750 at a time when its adjusted basis is $400 in accordance with an already established scale of straight-line depreciation. We hold that in such a case the deduction would be limited to $250.

The Motorlease Corporation, the taxpayer, is a Connecticut corporation engaged in leasing automobiles. After employing them in the leasing operation for a period of from one to two years, Motorlease generally disposes of the automobiles either by sale or trade-in on new auto-